Syarikat Pukin Ladang Kelapa Sawit Sdn Bhd v Ketua Pengarah Hasil Dalam Negeri

HIGH COURT (KUALA LUMPUR) — APPLICATION FOR JUDICIAL REVIEW NO R2–14–7 OF 2011
ROHANA YUSUF J
1 NOVEMBER 2011

Revenue Law — Income tax — Assessment — Appeal against deciding order of Special Commissioners — Whether advance rental paid for a lease of 60 years duration could be deducted as expense in the first basis year itself — Whether expenses wholly and exclusively incurred for production of gross income for that year — Advance rental annualised over lease period — Income Tax Act 1967 s 33

Revenue Law — Income tax — Deduction — Whether rental paid under lease agreement were expenses deductible — Pre-conditions for deductibility — Income Tax Act 1967 s 33

The appellant was a company carrying on the business of planting oil palm including processing and production of crude palm oil and palm kernel. The appellant took a lease of 17 pieces of land with a total area of approximately 7,932 acres ('the lands') under a lease agreement dated 22 February 2002 ('the lease agreement'). The lease was for a period of 60 years at a total rental of RM68,000,000. Clause 3.2 of the lease agreement required the appellant to pay RM18,000 upon execution of the lease, delivery of vacant possession and fulfilment of relevant approvals. The balance of the rentals were payable yearly. The appellant paid a total rental of RM18,000,000 made up of rental payment of RM1,392,000 for the basis year 2002 (YA 2002) and RM16,608,600 for the basis year 2003 (YA 2003). The appellant sought for this total rental of RM18,000,000 to be treated as deduction under s 33(1)(b) of the Income Tax Act 1967 ('the Act'). The director general of revenue ('DGR') did not recognise the total amount of RM18,000,000 as deductable expenses under s 33(1)(b). Instead, the DGR recognised only RM1,133,333.33 as deductable per year. The amount of RM1,133,333.33 was computed by annualising the total rental of RM68,000,000 over a period of 60 years. The appellant appealed before the SCIT on that decision. The SCIT decided in favour of the respondent. The SCIT made a finding that the expenses sought for deductions in this case was to be declined on the basis that it was capital expenditure under s 39(1)(c) of the Act. Hence this appeal. The issues raised on appeal were: (i) whether rental paid in accordance with the lease agreement were expenses deductible under s 33(1)(b); (ii) whether in restricting the allowance for deductible rental to be based on annual rental basis, the SCIT was unnecessarily restricting the

meaning of word 'rental' in s 33(1)(b) to exclude advanced rental; (iii) whether advanced rental in this case was capital expenses under s 39 of the Act; and (iv) whether the imposition of penalty was correctly made.

Held, dismissing the appeal:

(1) Under s 33 of the Act, expenses that are deductible include all outgoings and expenses wholly and exclusively incurred during that basis period. Such expenses must be wholly and exclusively incurred for the production of gross income for that year. As for rental, s 33(1)(b) clearly states that deductible rental refers to rent payable for that period. Therefore, under s 33, before expenses can be allowed deduction it must fulfill the two following elements: (i) the expenses must be wholly and exclusively incurred in that basis year; and (ii) the expenses must be wholly and exclusively incurred in the production of gross income (see para 17).

(2) Even though the sum of RM18,000,000 was contractually payable under the lease agreement they nevertheless represented advance rental. Advance rental cannot be taken in any circumstances to be expenses exclusive and wholly incurred for that basis year because although they are paid in advance, they are actually expenses to be incurred in the future for the production of gross future income. Advanced rental is not required for the purposes of the production of gross income in that basis period and hence cannot be expenses wholly and exclusively for the purpose of the production of gross income in that period (see para 19).

(3) The penalty imposed on the appellant was correctly made, and there was no misapplication of law or facts that merited interference by the court (see para 51).

(4) The SCIT had wrongly made a finding that the advance rental of RM18,000,000 could not be recognised under s 33 on the ground that it was capital expenses under s 39 of the Act. From the lease agreement it was clear that the amount of RM18,000,000 was not capital expenses but merely advance rental (see para 52).

[Bahasa Malaysia summary

Perayu merupakan sebuah syarikat yang menjalankan perniagaan penanaman kelapa sawit termasuk pemprosesan dan pengeluaran minyak sawit mentah dan isirung sawit. Perayu membuat pajakan 17 bidang tanah dengan keluasan kira-kira 7,932 ekar ('tanah') di bawah perjanjian pajakan bertarikh 22 Februari 2002 ('perjanjian pajakan'). Pajakan adalah untuk tempoh selama 60 tahun dengan jumlah sewa sebanyak RM68,000,000. Klausa 3.2 perjanjian pajakan memerlukan perayu untuk membayar RM18,000 selepas memeterai pajakan, pemberian milikan kosong dan memenuhi kebenaran-kebenaran yang berkenaan. Baki sewa perlu dibayar setiap tahun. Perayu membayar

sejumlah RM18,000,000 terdiri daripada bayaran RM1,392,000 untuk tahun asas 2002 (YA 2002) dan RM16,608,600 untuk tahun asas 2003 (YA 2003). Perayu memohon agar jumlah sewa RM18,000,000 dianggap sebagai pemotongan di bawah s 33(1)(b) Akta Cukai Pendapatan ('Akta'). Ketua Pengarah Hasil ('KPH') tidak mengiktiraf jumlah keseluruhan RM18,000,000 sebagai pembelanjaan boleh ditolak di bawah s 33(1)(b). Sebaliknya, KPH hanya mengiktiraf RM1,133,333.33 sebagai boleh ditolak setiap tahun. Jumlah RM1,133,333.33 dikira dengan membundarkan "annualizing" jumlah sewa RM68,000,000 bagi tempoh 60 tahun. Perayu merayu di hadapan SCIT atas keputusan tersebut. SCIT memutuskan bagi pihak responden. SCIT membuat dapatan bahawa perbelanjaan yang dipohon untuk pemotongan dalam kes ini perlu ditolak atas alasan ia merupakan modal perbelanjaan di bawah s 39(1)(c) Akta. Oleh itu rayuan ini dibuat. Isu-isu yang dikemukakan pada rayuan adalah: (i) sama ada sewa yang dibayar mengikut perjanjian pajakan merupakan perbelanjaan boleh ditolak di bawah s 33(1)(b); (ii) sama ada dalam menyekat kebenaran untuk potongan sewa berdasarkan sewa tahunan, SCIT secara tidak langsung mengehadkan perkataan 'sewa' dalam s 33(1)(b) untuk tidak termasuk sewa pendahuluan; (iii) sama ada sewa pendahuluan dalam kes ini merupakan modal perbelanjaan di bawah s 39 Akta; dan (iv) sama ada penalti yang dikenakan dibuat secara tepat.

Diputuskan, menolak rayuan:

(1) Di bawah s 33 Akta, perbelanjaan yang boleh dipotong adalah termasuk semua perbelanjaan keluar dan perbelanjaan yang digunakan sepenuhnya dan secara eksklusif pada tempoh asas tersebut. Perbelanjaan tersebut mestilah digunakan sepenuhnya dan secara eksklusif untuk pengeluaran pendapatan kasar untuk tahun tersebut. Untuk sewa, s 33(1)(b) secara jelas menyatakan bahawa sewa yang boleh ditolak merujuk kepada sewa yang perlu dibayar bagi tempoh tersebut. Oleh itu, di bawah s 33, sebelum perbelanjaan membenarkan potongan, ia mestilah memenuhi dua elemen ini: (i) perbelanjaan mestilah sepenuhnya dan secara eksklusifnya digunakan pada tahun asas tersebut; dan (ii) perbelanjaan mestilah sepenuhnya dan secara eksklusifnya digunakan dalam pengeluaran pendapatan kasar (lihat perenggan 17).

(2) Walaupun jumlah RM18,000,000 dikontrakkan perlu dibayar di bawah perjanjian pajakan namun jumlah tersebut juga mewakili sewa pendahuluan. Sewa pendahuluan tidak boleh dianggap dalam mana-mana keadaan sebagai perbelanjaan yang secara eksklusif dan sepenuhnya digunakan untuk tahun asas tersebut kerana walaupun ianya dibayar secara pendahuluan, ia merupakan perbelanjaan yang sepatutnya digunakan pada masa hadapan untuk pengeluaran pendapatan kasar masa depan. Sewa pendahuluan tidak diperlukan untuk tujuan-tujuan pengeluaran pendapatan kasar dalam tempoh asas tersebut dan oleh itu

bukan merupakan perbelanjaan yang sepenuhnya dan secara eksklusif bagi tujuan pengeluaran pendapatan kasar pada tempoh tersebut (lihat perenggan 19).

(3) Penalti yang dikenakan ke atas perayu adalah tepat dan tiada penyalahgunaan undang-undang atau fakta-fakta yang membolehkan campur tangan daripada mahkamah (lihat perenggan 51).

(4) SCIT tersilap dalam membuat dapatan bahawa sewa pendahuluan RM 18,000,000 tidak boleh diiktiraf di bawah s 33 atas alasan ia merupakan modal perbelanjaan di bawah s 39 Akta. Daripada perjanjian pajakan adalah jelas bahawa jumlah RM18,000,000 bukan merupakan modal perbelanjaan tetapi hanya merupakan sewa pendahuluan (lihat perenggan 52).]

Notes

For cases on assessment, see 10 *Mallal's Digest* (4th Ed, 2011 Reissue) paras 2384–2414.

For cases on deduction, see 10 *Mallal's Digest* (4th Ed, 2011 Reissue) paras 2384–2414.

Cases referred to

British Insulated and Helsby Cables Ltd v Atherton [1926] AC 205, HL (refd)

Cape Brandy Syndicate v Inland Revenue Commissioners (1921) 2 KB 403; 12 TC 358, CA (refd)

EK Sdn Bhd v Director-General of Inland Revenue [1977] 2 MLJ 263 (refd)

Gallagher v Jones (Inspector of Taxes) [1994] Ch 107, CA (refd)

Ketua Pengarah Hasil Dalam Negeri v Kim Thye & Co [1992] 2 MLJ 708; [1993] 1 BLJ 25, SC (refd)

National Land Finance Co-operative Society Ltd v Director General of Inland Revenue [1994] 1 MLJ 99; [1993] 2 AMR 52, SC (refd)

Port Elizabeth Electric Tramway Co Ltd v CIR (1935) 8 SATC 13 (refd)

Robinson v Scott Bader Co Ltd [1981] 2 All ER 1116; 54 TC 757, CA (refd)

Stephenson (Inspector of Taxes) v Payne, Stone, Frazer & Co [1968] 1 All ER 524; [1968] 1 WLR 858 (refd)

Strong & Co v Woodifield (1906) AC 448, HL (refd)

Vallambrosa Rubber Co Ltd v Farmer (1910) 5 TC 529 (refd)

Legislation referred to

Income Tax Act 1967 ss 2, 4, 33, 33(1), (1)(b), 39, 39(1), (1)(c), 113(1), (2), Schedule 5, para 34

Nik Saghir bin Mohd Noor (Nik Saghir & Ismail) for the appellant.

Norhisham bin Ahmad (Ahmad Ishak bin Hassan with him) (Inland Revenue Board) for the respondent.

Rohana Yusuf J:

[1] This is an appeal against the decision of the Special Commissioners of Income Tax (SCIT) by way of case stated pursuant to para 34 of Schedule 5 to the Income Tax Act 1967 (ITA).

[2] The salient facts of the case may be summarised as these. The appellant is a company carrying on the business of planting oil palm including processing and production of crude palm oil and palm kernel.

[3] The appellant took a lease of 17 pieces of land with a total area of approximately 7,932 acres ('the lands') under a lease agreement dated the 22 February 2002 from Pahangbif Sdn Bhd ('the lease agreement'). The lease is for a period of 60 years at a total rental of RM68,000,000. Clause 3.2 of the lease agreement requires the appellant to pay rentals as follows:

(a) within seven days of execution of the lease – RM1,392,000 agreement, deposit of duly executed Form 15A and upon delivery of vacant possession; and

(b) upon fulfilment of relevant approvals etc.

- RM16,608,000
RM18,000,000

[4] The balance of the rentals are payable yearly in the sums as set out in Appendix III to the lease agreement.

[5] The appellant paid a total rental of RM18,000,000 made up of rental payment of RM1,392,000 for the basis year 2002 (YA 2002) and RM16,608,600 for the basis year 2003 (YA 2003). The appellant sought for this total rental of RM18,000,000 to be treated as deduction under s 33(1)(b) of the ITA.

[6] The Director General of Revenue did not recognise the total amount of RM18,000,000 being rental paid by the appellant for the basis years YA 2002 and YA 2003 as deductable expenses under s 33(1)(b). Instead, the director general recognised only the amount of RM1,133,333.33 as deductable per year. The amount of RM1,133,333.33 is computed by annualising the total rental of RM68,000,000 over a period of 60 years. In other words, the total rental is expressed in yearly terms. In fact, it was also stated in the lease agreement in cl 3.1 that an annual average rental for the lease is RM1,133,333.33.

[7] The appellant appealed before the SCIT on that decision. The SCIT deliberated on two main issues raised before them at the appeal. Firstly, whether it was correct in law for the respondent to restrict the deduction of rentals paid in the basis years for YA 2002 and YA 2003 only to the extent of RM1,133,333.33 per year (based on an annualised rental) and not the whole of rental actually paid, that is, the sum of RM1,392,000 for YA 2002 and RM16,608,000 for YA 2003.

[8] Secondly, whether the penalty imposed was proper and not excessive in the circumstances of the case. On both issues the SCIT decided in favour of the respondent, hence this appeal.

[9] Section 33 of the ITA provides for what amounts to deductible expenses for the basis period. Deductable expenses are expenses that can be deducted from the gross income of a taxpayer. Expenses that can be deducted for the basis year includes all outgoings and expenses which are *wholly and exclusively* incurred during that basis period in the production of gross income of that period.

[10] For convenience, the relevant part of s 33(1) of the ITA is reproduced below:

> 33(1) Subject to this Act, the adjusted income of a person from a source for the basis period for a year of assessment shall be an amount ascertained by deducting from the gross income of that person from that source for that period all outgoings and expenses *wholly and exclusively incurred during that period* by that person in the production of gross income from that source, including —
>
> (a) …
>
> (b) *rent payable for that period* (or for any part of that period) by that persons in respect of any land or building or part thereof occupied by him that period for the purpose of producing gross income from that source; (Emphasis added.)

[11] Learned counsel for the appellant Encik Nik Saghir bin Mohd Noor contended that in arriving at its decision, the SCIT in annualising the rental had caused the word 'rent' in s 33 to be restricted to an average annual rental. He contended, the SCIT erred in arriving at its decision to restrict deductable rental based on annual computation and thereby restricted the word annual rental payable in s 33(1)(b) to exclude advance rental, which may be payable for that basis year. In so doing the appellant contended, the SCIT had misinterpreted this legal provision for failure to adhere to the often-repeated rule of interpretation of taxing laws enunciated by Rowlatt J in *Cape Brandy Syndicate v Inland Revenue Commissioners* (1921) 2 KB 403; 12 TC 358. This case was adopted by our Supreme Court in *National Land Finance Co-operative*

Society Ltd v Director General of Inland Revenue [1994] 1 MLJ 99; [1993] 2 AMR 52. The word 'rent' is widely interpreted under s 2 of the ITA and should include advance rental as well. The appellant further relied on the case *EK Sdn Bhd v Director-General of Inland Revenue* [1977] 2 MLJ 263.

[12] Alternatively, the appellant contended that rentals paid in the sums of RM1,392,000 in 2002 and RM16,608,000 in 2003 are 'expenses wholly and exclusively incurred in the production of gross income' under s 33(1) of the ITA. On this basis itself, the rentals paid by the appellant under the lease agreement for the years 2002 and 2003 totalling to RM18,000,000 are deductable expenses under the same.

[13] It is also the appellant's case that the SCIT had erred in denying the appellant's appeal on the basis that the expenses paid above the average annual rental was capital expenditure applying s 39(1)(c). This is because the expenses are not capital expenditure but advance rental.

[14] Learned counsel for revenue, contended that there was no error or misinterpretation by SCIT as contended by the appellant. The SCIT was correct that under s 33(1)(b) only annual rental should be recognised. Since the lease term is for a 60-year period and the annual rental as stated under cl 3.1 is RM1,133,333.33 under s 33(1)(b), the amount of rental allowed should be based on annual average lease and not the amount in fact paid under the lease agreement. The SCIT, according to learned counsel had, in arriving at its decision adhered to the principle of strict interpretation of taxing law and hence there is no reason for this court to disturb.

[15] Further to that the revenue argued, based on cl 3.2 of the lease agreement and the payment stipulated thereunder, and as explained by the witnesses the SCIT found as of fact that the payment of RM18,000,000 made was intended for the purpose of obtaining the right to lease and to remove caveat. These payment, learned counsel for revenue submitted, are therefore capital expenditure under s 39(1) of the ITA, and not rental perse.

[16] Having appraised with the findings of the SCIT and taken into account the arguments and submissions by learned counsel for the appellant and learned counsel for the revenue, the issues before this court can be summed up as follows:

(a) whether rental paid in accordance with the lease agreement, which had in fact been paid, are expenses deductible under s 33(1)(b);

(b) whether in restricting the allowance for deductible rental to be based on annual rental basis, the SCIT is unnecessarily restricting the meaning of word 'rental' in s 33(1)(b) to exclude advanced rental;

(c) whether advanced rental in this case is capital expenses under s 39 of the ITA; and

(d) whether the imposition of penalty is correctly made.

THE FINDINGS

[17] If we were to look at the s 33 of the ITA above, expenses that are deductible includes all outgoings and expenses *wholly and exclusively* incurred during that basis period. Further, such expenses must be *wholly and exclusively incurred for the production of gross income for that year is allowed deduction.* As for rental, s 33(1)(b) clearly states that deductible rental refers to *rent payable for that period* (or for any part of that period) in respect of any land or building or part thereof occupied by the tax payer in that period for the purpose of producing gross income from that source. Therefore, it may be said that under s 33, before expenses can be allowed deduction it must fulfil two following elements and they must be read conjunctively:

(a) the expenses must be wholly and exclusively incurred in that basis year; and

(b) the expenses must be wholly and exclusively incurred in the production of gross income.

[18] In this case, the amount of rental paid under cl 3.2 of the lease agreement amounts to RM18,000,000, which in fact covers a period of two basis years, namely 2002 and 2003. The SCIT arrived at its conclusion based on the undisputed facts that the lease was for a period of 60 years. The total lease amount of RM68,000,000 was annualised for the total lease period giving an annual rental of RM1,133,333.33 per year. Thus instead of the total sum payable (amount under cl 3.2 of the lease agreement) in the amount of RM18,000,000 for the two basis year 2002 and 2003, the SCIT upheld the decision of the respondent to restrict the deductible sums to an annualised basis and not the actual paid pursuant to the lease agreement.

[19] Following from the above findings of facts, can we then say that these advance rentals are *expenses wholly and exclusively incurred for the basis year and in the production of gross income for that period?* In my view, this cannot be so. Even though it is a fact that the sum of RM18,000,000 is contractually payable under the lease agreement they nevertheless represent advance rental. Advance rental cannot be taken in any circumstances to be expenses *exclusive and wholly* incurred for that basis year because although they are paid in advance, they are actually expenses to be incurred in the future for the production of gross future income. In other words, for the production of the gross income for the basis

year in question, the only required rental to be paid is an annual rental. Advanced rental is not required for the purposes of the production of gross income in that basis period and hence cannot be expenses wholly and exclusively for the purpose of the production of gross income in that period.

[20] It must be noted that the words 'for that period' is not defined under the ITA but it must necessarily refer to the 'basis period of a year of assessment'. There is no disagreement between parties on this point.

[21] Learned counsel for the appellant contended that there is no definition of 'payable' under the ITA. The appellant agreed on the SCIT resorting to dictionary meaning which is according to *Oxford English Dictionary* it means 'the sum of money, bill etc: That is due to be paid; due, owing, falling due (usually on specified date or to a specified person' Taking it literally, what is payable in this context in the contention of learned counsel for the appellant has to be referred to the provisions under the lease agreement which is provided under cl 3.2. Thus, the appellant contended, *rental payable for that period* means rental that the appellant is contractually obliged and payable under the lease agreement for that period.

[22] Conversely, the SCIT interpreted *rental payable for that period* to mean what rental should or ought to be paid during *that period* as intended under s 33. No dispute between parties as to what that period means. It has to the basis year. Since that period means that basis year any rental, which is paid over and above the amount that should or ought to be paid for that year (advance rental) is not captured by this provision.

[23] Thus in my view the decision of the SCIT which finds rental payable in that period cannot refer to what the lease agreement stipulates. It must be read in the context of deductable expenses as envisaged under s 33. The deductable expenses envisaged under s 33 are expenses that are *wholly and exclusively incurred during that period in the production of gross income.*

[24] For the production of gross income in that period the rental that is required is merely an annual rental and cannot therefore include advanced rental. Advance rental would not be expenses that are wholly or exclusively required to produce the gross income for that basis year.

[25] The SCIT therefore is right in applying the phrase *rent payable during that period* under s 33 to mean the rental payment, which ought to be due during that basis period and not what the lease agreement says. In a basis period of one year, the deductable income must be confined to the expenses required to produce the gross income for that year.

[26] I am further fortified on this interpretation by the English decision of *Stephenson (Inspector of Taxes) v Payne, Stone, Frazer & Co* [1968] 1 All ER 524; [1968] 1 WLR 858. In that case, the taxpayer was a firm of accountants. It established a service company to provide secretarial and other services to the firm. The charges was agreed to be only minimal. For year 1961, the actual cost of the services was £32,000 but the parties agreed for the charges to be £47,000. This was in excess of £15,000 of the actual cost. This resulted in the reduction of profit of the firm for tax purposes on its first year of business. This £15,000 in excess was to be deducted for sums payable in the future years. It was held in that case that the £15,000 should be disallowed as outgoings in computing the taxpayer's firm profit because it was a misattribution and contrary to the ordinary principles of commercial accounting.

[27] Learned counsel for the applicant submitted that the above case cannot apply and is distinguishable with the present case because the facts and statutory provisions differ. The amount of £47,000 claimed in *Stephenson* was in excess of actual costs of services whereas in the present case the sum of RM18,000,000 were actually paid as rentals and that the annual rental of RM1,133,333.33 was not the actual rental payable for the year. Learned counsel also reminded that the decision in Stephenson seems to lay emphasis on the principle of commercial accounting whereas the present case dealt with s 33. Similarly, learned counsel argued that in the other English case *Gallagher v Jones (Inspector of Taxes)* [1994] Ch 107 the reason for non-deductibility is also based on issues of commercial accounting and hence is of no application to the present case.

[28] I have examined these two English cases, in particular on the issue of advance cost of service and advance rental. In *Stephenson* the judge remarked that the misattribution in that case is manifestly contrary to ordinary principles of commercial accounting which ultimately distort the true balance of profit of taxpayer. In the same light in my view to allow the deductable rental based on the advance rental as in this case would ultimately affect and distort the true balance sheet and profit of the taxpayer. This would mean that the total gross income and the total expenditure envisaged by s 33 would be distorted and this would defeat the whole principle of allowing deductable expenses only in relation to the production of gross income in the basis year. In the same way as the English cases above, it would lead to misattribution.

[29] In the second case *Gallagher v Jones (Inspector of Taxes)* [1994] Ch 107, the taxpayer was in the business of hiring narrow boats. The taxpayer entered into leasing agreements with a finance company for acquisition of three boats upon the terms. For a primary period of 24 months substantial rental was to be made, this was followed by 17 monthly payment and then for the secondary period at annual rental of £5. The taxpayer applied for a deduction of the whole

substantial initial rental for the primary period. On appeal to the Special Commissioners, it was disallowed on the basis that it was not based on commercial method of accounting and it did not reflect the taxpayer's trading result. This decision was upheld by the Court of Appeal. The Court of Appeal of England agreed that the account did not reflect a true and fair view of the result of the period.

[30] Learned counsel for the applicant contended that *Gallagher*'s case lays emphasis on the importance of accepted principles of commercial accounting but there was never an issue in the present case. Besides, learned counsel submitted that in *Gallagher*'s case, the lease was a financial lease and the account must comply with the required standard accounting practice, whereas in the present appeal it involves operating lease and hence is of not application here.

[31] There is no doubt that the tax statute in England is not similar with the provisions of the ITA. However, the principle deduced from these two cases, in my view, concern with the ultimate distortion of the trading result in the basis year.

[32] Looking at the scheme of s 33 overall, the principle of deductable expenses is inextricably linked to expenses in the basis year and will ultimately distort the trading result of the basis year. For this reason, I have no hesitation to accept the decision of the SCIT on this point.

[33] I now come to the alternative argument by the appellant that, s 33(1) can apply in the instant appeal on the basis that the actual amount of rentals paid by the appellant were in fact paid in the period and they were therefore expenses wholly and exclusively incurred for that year. Firstly, I do not agree that the general clause of s 33 should be resorted to because s 33(1)(b) applies in specific to rental. Secondly, even if s 33 applies the concept of deductable expenses envisaged by this section generally cannot recognise advance rental as I have earlier explained.

[34] It must be emphasised that s 33(1)(b) has to be interpreted in the light of the principles of deductibility as I have earlier alluded to in the earlier paragraphs. I can accept the argument that the rentals paid by the appellant were expenses in fact incurred in the basis year. Nevertheless, a plain reading of s 33 shows that deductibility is based on the test of whether the 'expenses is wholly and exclusively made in the production of gross income'. The word 'wholly' is defined in *Strong & Co of Romsey Ltd v Woodifield* (1906) AC 448 to exclude expenses which are remotely connected.

[35] What is production of gross income has been defined in *Port Elizabeth*

Electric Tramway Co Ltd v CIR (1935) 8 SATC 13 as expenditure which must be looked to as is performed for the purpose of earning income. Such expenses must be attached to the performance of business operation, performed bona fide for earning income. All in all, the test of 'wholly and exclusively' have to be based on the facts of each case based on ordinary commercial trading. According to Lord Davey in the case of *Strong & Co of Romsey Ltd v Woodifield* (1906) AC 448 in order to make a particular disbursement deductable it is not enough that the expenses is made in the course of or connected with trade but it has to be made for purpose of earning profit.

[36] It is clear from the facts of the present case that the total lease paid by the appellant for the years 2002 and 2003 are *advance lease* made as an obligation under cl 3.2 of the lease agreement between the appellant and Pahangbif Sdn Bhd. Since the lease paid is in essence advance lease it must necessarily fail the test of it being expenses *wholly and exclusively* incurred in that year.

[37] This, in the contention of Encik Nik Saghir will lead to an interpretation that will distort the plain meaning of 'rent' in s 2 of the ITA. The definition of rent includes advance rental as decided in *EK Sdn Bhd v Director General of Inland Revenue* [1977] 2 MLJ 263. With respect, in my view the word 'rent' in that case was said to include advance rental, which are assessable income under s 4 of the ITA. In that case rent was regarded as gross income because the learned judge was of the view that the word rent under s 2 is not exhaustively defined by virtue of how the definition was drafted, which states that 'rent includes …'. It may well be the case that advance rental is gross income.

[38] In the present case we are concern with rent payable in the basis period, which should or should not be treated as *expenses wholly and exclusively incurred for the production of gross income.* Thus advance rental to my mind cannot fall under this category and this is further reinforced by the observation of Lord Davey in *Strong & Co of Romsey Ltd v Woodifield* (1906) AC 448 that, in order to make a particular disbursement deductable, it has to be made for purpose of earning profit. Advance rental cannot therefore be construed or be said to be expenses for the purpose of earning profit in any circumstances for that basis year. On these reasons it is my considered view that even applying the test in s 33(1), advance rental in this case does not meet the necessary test.

CAPITAL EXPENDITURE

[39] I now come to another issue observed by the SCIT. Learned counsel for revenue contended that under cl 3.2 of the lease agreement the payment made tantamount to capital expenditure under s 39(1)(c) of the ITA. This is also one of the deciding order of the SCIT. The SCIT relied on the evidence of AW1

who testified that without paying the whole RM18,000,000 the appellant cannot occupy the land. The SCIT then resorted to the definition of 'capital expense' in *Black's Law Dictionary*, which states that it is 'an expense made by a business to provide a long term benefit. This capital expense is not deductible but it can be used for depreciation or amortisation'. The case of *Robinson v Scott Bader Co Ltd (CA)* [1981] 2 All ER 1116; 54 TC 757 relied upon by SCIT held that the object of expenditure must be looked at, following a subjective test and hence it is a question of fact.

[40] It was found by the SCIT from testimonies before the SCIT that, the appellant agreed to pay this extra RM15,333,333.34 in advance, an extra whopping sum on 'only once and for all basis' and as decided in *Vallambrosa Rubber Co. Ltd v Farmer* (1910) 5 TC 529, it is a payment to secure an asset or an advantage for enduring benefit of a trade (see *British Insulated and Helsby Cables Ltd v Atherton* (1926) AC 205).

[41] Section 39 of the ITA is a provision that deals with prohibited deduction. The SCIT in this case had also made a finding that the expenses sought for deductions in this case is declined on the basis that is capital expenditure as provided under s 39(1)(c) of the ITA. Section 39(1)(c) provides:

> 39 Deductions not allowed
>
> (1) Subject to any express provision of this Act, in ascertaining the adjusted income of any person from any source for the basis period for a year of assessment no deduction from the gross income from that source for that period shall be allowed in respect of —
>
> (c) any capital withdrawn or any sum employed or intended to be employed as capital;

[42] A careful examination of cl 3.2 of the lease agreement relates to removal of caveat or encumbrances on the said land. However the lease agreement does not impose any obligation on the appellant to remove the caveat. The obligation of the appellant under the lease agreement is to pay rental lease. In *British Insulated and Helsby Ltd v Atherton* [1926] AC 205, a case relied by the SCIT Viscount Cave LJ said:

> But when expenditure is made not only once and for all, but with a view to bringing into existence an asset or an advantage for the enduring benefit of a trade, I think that there is a very good reason (in the absence of special circumstances leading to the opposite conclusion) for treating such an expenditure as properly attributed not to revenue but to capital.

[43] Looking at the lease agreement as the whole, the construction of cl 3.2 by SCIT to find that the payment made was to obtain the right to lease and to

remove caveat, is inaccurate. There is no obligation imposed on the appellant to remove caveat under the lease agreement and for that reason it cannot therefore be construed as a payment for that purpose. I agree with learned counsel for the appellant that cl 3.2(b)(i) only explains that upon receipt of confirmation of actual amount due to LKPT to remove encumbrances. This is only an event that triggers payment of the advance lease of RM18,000,000. There is nothing to suggest that it is for payment of removing the caveat.

[44] I have also considered the case cited by learned counsel for revenue in *Robinson v Scott Bader Co Ltd (CA)* [1981] 2 All ER 1116; 54 TC 757. It was held in that case that the test to be applied is what is the object of making the disbursement and the effect of it. It is clear that the payment made by the appellant here is lease rental payment. It is to all intents and purposes advance rental agreed by parties to be paid in advance. This is because the RM18,000,000 paid is computed as part of the total rental of RM68,000,000 for the 60-year lease. After deducting that amount from the total lease of RM68,000,000, a balance of RM40,000,000 is to be paid in accordance with Schedule 111 of the lease agreement. It is therefore not possible for this sum to be treated as capital expenditure.

PENALTY IMPOSITION

[45] On the issue of penalty, the argument by learned counsel for the appellant was that before s 113(2) can be invoked, it must be satisfied that the appellant has:

(a) made an incorrect return by omitting or understating any income; and

(b) given any incorrect information.

[46] Under s 113(1) when a person makes incorrect returns or gives incorrect information he can be guilty of an offence and be liable to fine and special penalty double the undercharged tax consequential to that incorrect returns or information. A defence of good faith is provided under s 113(1) of the ITA. Section 113(2) would operate only if there is no prosecution made under s 113(1). Thus for the same wrong, that is, making incorrect returns or wrongful information, a person who is not charged under s 113(1) can be imposed with penalty under s 113(2). Reading the two provisions quite obviously it is implied this provision operates with or without bad faith. The Supreme Court in *Ketua Pengarah Hasil Dalam Negeri v Kim Thye & Co* [1992] 2 MLJ 708; [1993] 1 BLJ 25 explained that the objective of assessment of tax contemplates filling of correct returns by taxpayer. Filling incorrect returns attracts a penalty under s 113(2) of the ITA. The court in that case held that this provision vested discretion in the Revenue Board, a discretion that cannot be exercised at whim and fancy.

[47] The evidence in this case shows that the Revenue Board became aware of the RM18,000,000 claimed as deduction only upon auditing. Not for the auditing the respondent would not be aware that the deductable rental should be lesser instead. The appellant therefore would be paying less tax. The contention by the appellant that it was made in good faith due to the differing interpretation of the law cannot hold because ignorance of law cannot be a defence.

[48] This country is now adopting a self-assessment regime. Thus in line with the present policy where submission of returns are based on self assessment by tax payer, a tax payer must be mindful of his responsibility to submit correct returns and must necessarily do so upon necessary consultation to ensure correct returns are submitted.

[49] That said, in my view the SCIT had scrutinised the evidence relied upon by the respondent in imposing this penalty, there is no misdirection of law to the facts for which this court should intervene.

[50] In conclusion I hold as follows; s 33(1)(b) recognise 'rental payable' not as provided under the lease agreement but it must be based on the calculation of rental ought to have been incurred in the basis year based on the principle of *expenses wholly and exclusively incurred for the production of gross income in the basis year,* thus in coming to its decision that only annual rental is to be recognised under s 33(1)(b) of the SCIT is therefore right in excluding advanced rental, The appeal of the appellant on this ground is therefore dismissed.

[51] The penalty imposed on the appellant was correctly made, no misapplication of law or facts that merits interference by this court. On this reason the appeal of the appellant on this issue is also dismissed.

[52] The SCIT however, had wrongly made a finding that the advance rental of RM18,000,000 cannot be recognised under s 33 on the ground that it is capital expenses under s 39 of the ITA. From the lease agreement it is clear that the amount of RM18,000,000 is not capital expenses but merely advance rental.

[53] In the circumstances, I hereby dismiss the appeal of the appellant and I make no order as to costs.

Appeal dismissed.

Reported by Ashok Kumar